

State of Alaska FY2008 Governor's Operating Budget

Department of Law Oil, Gas and Mining Component Budget Summary

Component: Oil, Gas and Mining

Contribution to Department's Mission

The Oil, Gas and Mining section provides advice and representation to various departments and agencies of state government to assist them in the performance of their functions.

Core Services

The Oil, Gas, and Mining section is responsible for in-house department of Law services in oil, gas, and mining-related disputes including:

1. legal representation to state agencies for the investigation, defense, and prosecution of claims concerning the state's oil and gas royalty and taxation programs;
2. monitoring and protesting tariffs charged for transportation of oil and gas production through pipelines; and
3. legal advice to state agencies concerning the development of state oil, gas, and mineral resources.

Department attorneys must frequently rely on economists, engineers, and other experts to address these highly technical oil and gas issues. Moreover, due to the complexity, length, and magnitude of major tax, royalty, tariff, and antitrust cases, outside counsel must sometimes be used to help in these disputes.

Most of the state's operating revenues are derived from oil and gas corporate income taxes, production taxes, and royalties on Alaska North Slope ("ANS") crude oil. The value of that crude for production tax and royalty purposes is largely determined by the price that ANS commands in its destination markets, less the costs of transporting it to those markets. The transportation costs, in turn, consist primarily of the tariffs charged by the Trans-Alaska Pipeline System ("TAPS") and the producers' tanker costs. Accurately determining ANS destination values, allowable transportation costs, and corporate income ensures the integrity of the state's fiscal system. The Oil, Gas and Mining component funds legal services related to these and other oil and gas development issues. These services include tariff monitoring and disputes with the owners of TAPS and other oil pipelines in Alaska, and the assessment and collection of unpaid royalties and taxes from oil and gas producers. The contracts with outside counsel and expert consultants on large or complex oil and gas cases are also funded by this component, as are the legal services related to lease sales, drafting and interpreting oil and gas statutes and regulations, pipeline right-of-way issues, and oil and gas conservation.

FY2008 Resources Allocated to Achieve Results

FY2008 Component Budget: \$5,195,900	Personnel:	
	Full time	29
	Part time	0
	Total	29

Key Component Challenges

OIL AND GAS PIPELINE-RELATED MATTERS

The Oil, Gas, and Mining section expends substantial resources to monitor the TAPS owners' compliance with the 1985 TAPS settlement agreement, and to monitor and participate where appropriate in state and federal regulatory oversight of the tariffs of all oil and gas pipelines operating in the state. This vigilance can earn the state millions of dollars in royalties and production taxes each year. Further, as production of oil and gas from current developments declines in Alaska, the state's participation in tariff regulation is becoming more and more important in encouraging additional

producers to invest in exploration of new areas in the state, by ensuring fair transportation rates and access to existing pipeline infrastructure for production from new fields.

During FY2008 the Oil, Gas and Mining section will be participating in briefing and other post-hearing proceedings stemming from the state's discrimination challenge to the TAPS' 2005 -2006 interstate tariffs. The State will also examine the TAPS carriers' proposed 2008 tariffs and consider whether they are justified. The State must also determine whether to open negotiations on the TAPS Interstate and Intrastate Settlement Agreements that were executed in 1985 and expire by their terms in 2011. If so, those negotiations will take place in FY2007 and FY2008. Finally, the State's protest of expenditures by the TAPS' carriers on the Strategic Reconfiguration project will proceed through discovery and hearing processes at the Federal Energy Regulatory Commission (FERC) through FY2008. A scheduling hearing on the Strategic Reconfiguration protests is scheduled before the FERC in March 2007.

The section will continue negotiations with Cook Inlet area gas pipeline owners on the opening to regulated access of all Cook Inlet area gas pipeline infrastructure -- to facilitate and encourage new gas production and producers -- and will support acceptance of the tariffs developed through those negotiated settlements in proceedings at the Regulatory Commission of Alaska (RCA). The section will also continue to participate in several administrative appeals related to intrastate TAPS tariffs.

Another case that has not been resolved involves a dispute among TAPS shippers and the state over the appropriate method to determine quality bank adjustments, which are payments made to compensate for the different qualities of crude oil and refinery return streams that are commingled in TAPS. FERC and RCA decisions have spawned numerous court appeals. The Oil, Gas and Mining section will continue to monitor the tariffs of the so-called North Slope feeder pipelines that transport oil from remote fields to TAPS.

Finally, the section will be involved in regulatory proceedings before the RCA relating to the development of gas storage facilities in the Cook Inlet area.

GAS PIPELINE-RELATED ISSUES

Arrangements to construct a gasline to transport Alaska North Slope gas to market will continue to sit at the top of the FY2008 department of Law's priority "to do" list. The known gas resource on Alaska's North Slope is huge. The potential gas resource on unexplored lands on the North Slope is much larger. Developing this resource is one of the most promising opportunities to strengthen and support Alaska's economic future.

The key to unlocking the North Slope gas resource is the construction of a pipeline to transport this gas to markets both inside and outside of Alaska. To expedite the construction of the needed gas transportation system, the state has expressed interest to enter into a contractual arrangement with potential gasline developers. It is unknown whether final contractual arrangements will take place within or outside the scope of the Stranded Gas Development Act. Moreover, it is unknown whether contractual arrangements will be made for both midstream and upstream elements, or just one of these, or will include state ownership of the project.

In preparing this budget the department has assumed the state will enter into or continue complex and lengthy negotiations with one or more parties. Moreover, the department is anticipating that complex issues involving state ownership of a gasline, financing, federal regulation, and fiscal certainty will likely arise.

Assuming a contract is agreed to and approved by the Legislature, during FY2008 the department anticipates there will be at least one legal challenge to the legality of the contract. In addition, the department will be required to draft legislative or regulatory language necessary to implement any changes to the state's fiscal regime or other state laws that will improve the viability of the project, and assist other agencies with their various permitting responsibilities related to the project.

Moreover, if the successful applicant or applicants files an application for a certificate of public convenience and necessity with the FERC, the Oil, Gas and Mining section will be responsible for representing the state's interests in the project. Both in-house and outside counsel will be used in this endeavor.

The section must also provide legal support to the Alaska Natural Gas Development Authority created by citizen's initiative in the November 2002 statewide election.

The department has used specialized outside counsel to assist it in drafting and negotiating the complex commercial

terms in previous draft gasline contracts and to provide counsel on matters such as FERC oversight and the availability of financial mechanisms to fund state ownership if that is desired. The department's funding request anticipates the continuing need for the extensive involvement of such outside counsel.

TAX CASES

This department is pursuing millions of dollars in past-due taxes and interest that are owed by oil and gas producers to the state. In some cases, thousands of documents have to be examined and many potential witnesses must be interviewed or deposed in order to prepare for hearing. These hearings can last for weeks. At this time, two major tax cases are before the Office of Administrative Hearings. Another major case at the informal conference stage is an appeal of the department of Revenue's decision to aggregate properties within the Prudhoe Bay Unit for purposes of determining the Economic Limit Factor.

The department also provides support and represents the Department of Revenue in appeals from the annual oil and gas property tax assessments, including the valuation of TAPS for taxes due. The owners of TAPS appealed the Department of Revenue's 2006 assessment of TAPS to the Superior court and two affected municipalities cross-appealed. This case may go to trial in 2007, requiring the department to contract the services of experts in appraisal and assessment practice.

The department will be required to provide substantial legal assistance to the department of Revenue in its formulation and adoption of regulations stemming from enactment of the Petroleum Production Tax (PPT) legislation.

Finally, if the Gas Reserves Tax initiative passes in the November election, the department anticipates that one or more affected parties may sue to challenge the legality of the tax.

ROYALTY CASES

Royalty disputes regularly arise between the oil and gas producers and the state. Although the department handles most of these disputes in-house, assistance from outside counsel and experts is sometimes necessary. In FY2008, either the state or its lessees may reopen negotiations over the previously settled Alaska North Slope royalty disputes based on changes in marketplace value and transportation costs. The department may require assistance from specialized outside trial counsel and experts originally involved in the royalty dispute to resolve these reopeners.

In November, 2006, the Department of Natural Resources is conducting an administrative hearing regarding the future of the Pt. Thomson unit. Depending on the outcome of that hearing, the department may be involved in litigation.

MINING

The challenges include ongoing support and/or litigation regarding mineral royalties, mining rights, and rights regarding surface occupancy of mining claims. Department attorneys also assist the Department of Natural Resources (DNR) in complying with federal statutes regulating surface mining, including legal review for the use of reclamation funds, and drafting agreement with operators to insure compliance with state and federal reclamation requirements. The section also advises and assists the Division of Mining in drafting bonding agreements, permits, leases, best interest findings, proposed legislation, and regulations.

MISCELLANEOUS

The department is working with other state agencies to examine any liability to the state stemming from the corrosion to North Slope feeder lines. This matter may result in litigation.

Significant Changes in Results to be Delivered in FY2008

The Oil, Gas and Mining section's legal assistance will improve the efficiency of our client agencies' effort to spur new resource development thereby increasing public revenue and other benefits from that development.

The business climate for resource development will improve with fair and efficient resolution of litigation pertaining to:

- (1) regulatory barriers to resource development;
- (2) access to existing pipeline infrastructure for new-to-Alaska oil and gas producers; and

(3) developers' tax and royalty obligations to the State of Alaska.

This litigation will also move in-state pipelines toward lower transportation rates, and thus increase state royalties and production taxes.

Major Component Accomplishments in 2006

The section assisted the Governor's office and the departments of Natural Resources and Revenue in complex and intensive negotiations in an effort to achieve a gasoline contract. The section engaged in drafting detailed contract provisions and analyzing constitutional and other state law issues relevant to the contract that was presented to the Legislature.

The section assisted the Department of Revenue in analyzing and drafting complex legislation related to fundamental changes to the state's oil and gas production tax regime.

The section assisted the Department of Revenue in negotiating a settlement with a major oil and gas producer that resulted in the producer paying over \$66 million in additional income tax and interest to the state.

The section assisted the Department of Natural Resources in settling a royalty dispute with a major oil and gas producer on the eve of arbitration that resulted in a net benefit to the state of over \$30 million.

Statutory and Regulatory Authority

AS 44.23.020

Contact Information

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Oil, Gas and Mining Component Financial Summary

All dollars shown in thousands

	FY2006 Actuals	FY2007 Management Plan	FY2008 Governor
Non-Formula Program:			
Component Expenditures:			
71000 Personal Services	2,620.1	2,699.3	3,090.1
72000 Travel	113.8	79.2	79.2
73000 Services	14,555.4	3,774.9	1,972.4
74000 Commodities	46.0	54.2	54.2
75000 Capital Outlay	0.0	0.0	0.0
77000 Grants, Benefits	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
Expenditure Totals	17,335.3	6,607.6	5,195.9
Funding Sources:			
1004 General Fund Receipts	16,967.8	5,130.6	3,718.9
1007 Inter-Agency Receipts	367.5	0.0	0.0
1105 Alaska Permanent Fund Corporation Receipts	0.0	1,477.0	1,477.0
Funding Totals	17,335.3	6,607.6	5,195.9

Estimated Revenue Collections

Description	Master Revenue Account	FY2006 Actuals	FY2007 Management Plan	FY2008 Governor
Unrestricted Revenues				
None.		0.0	0.0	0.0
Unrestricted Total		0.0	0.0	0.0
Restricted Revenues				
Interagency Receipts	51015	367.5	0.0	0.0
Permanent Fund Earnings Reserve Account	51373	0.0	1,477.0	1,477.0
Restricted Total		367.5	1,477.0	1,477.0
Total Estimated Revenues		367.5	1,477.0	1,477.0

**Summary of Component Budget Changes
From FY2007 Management Plan to FY2008 Governor**

All dollars shown in thousands

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
FY2007 Management Plan	5,130.6	0.0	1,477.0	6,607.6
Adjustments which will continue current level of service:				
-Remove Gas Pipeline and Other Oil & Gas Projects Sec 16 CH 33 SLA 2006 P 68 L 7 (HB365) Lapses 6/30/07	-1,500.0	0.0	0.0	-1,500.0
-Remove Gas Pipeline and Other Oil & Gas Projects Sec 33(b) CH 82 SLA 2006 P 150 L 23 (SB231) Lapses 6/30/07	-302.5	0.0	0.0	-302.5
-FY 08 Health Insurance Increases for Exempt Employees	3.0	0.0	0.0	3.0
Proposed budget increases:				
-FY 08 Retirement Systems Rate Increases	387.8	0.0	0.0	387.8
FY2008 Governor	3,718.9	0.0	1,477.0	5,195.9

**Oil, Gas and Mining
Personal Services Information**

Authorized Positions			Personal Services Costs	
	<u>FY2007</u> <u>Management</u> <u>Plan</u>	<u>FY2008</u> <u>Governor</u>		
Full-time	29	29	Annual Salaries	1,815,786
Part-time	0	0	Premium Pay	0
Nonpermanent	0	0	Annual Benefits	1,294,120
			<i>Less 0.64% Vacancy Factor</i>	(19,806)
			Lump Sum Premium Pay	0
Totals	29	29	Total Personal Services	3,090,100

Position Classification Summary

Job Class Title	Anchorage	Fairbanks	Juneau	Others	Total
Accounting Clerk II	0	0	1	0	1
Analyst/Programmer IV	1	0	0	0	1
Assoc Attorney I	1	0	1	0	2
Assoc Attorney II	1	0	0	0	1
Attorney III	0	0	2	0	2
Attorney IV	5	0	1	0	6
Attorney V	2	0	3	0	5
Attorney VI	1	0	0	0	1
Data Processing Mgr I	0	0	1	0	1
Law Office Assistant I	2	0	2	0	4
Paralegal II	3	0	1	0	4
Procurement Spec III	0	0	1	0	1
Totals	16	0	13	0	29